Coversheet

This is the accepted manuscript (post-print version) of the article.
Contentwise, the post-print version is identical to the final published version, but there may be differences in typography and layout.

How to cite this publication
Please cite the final published version:


Publication metadata

<table>
<thead>
<tr>
<th>Title:</th>
<th>The Role of the EU Institutions in Establishing the European Stability Mechanism: Institutional Leadership under a Veil of Intergovernmentalism</th>
</tr>
</thead>
<tbody>
<tr>
<td>Author(s):</td>
<td>Sandrino Smeets, Alenka Jaschke, Derek Beach</td>
</tr>
<tr>
<td>Journal:</td>
<td>Journal of Common Market Studies, 57(4), 675-691</td>
</tr>
<tr>
<td>DOI/Link:</td>
<td><a href="https://doi.org/10.1111/jcms.12842">https://doi.org/10.1111/jcms.12842</a></td>
</tr>
<tr>
<td>Document version:</td>
<td>Accepted manuscript (post-print)</td>
</tr>
</tbody>
</table>

General Rights
Copyright and moral rights for the publications made accessible in the public portal are retained by the authors and/or other copyright owners and it is a condition of accessing publications that users recognize and abide by the legal requirements associated with these rights.

- Users may download and print one copy of any publication from the public portal for the purpose of private study or research.
- You may not further distribute the material or use it for any profit-making activity or commercial gain
- You may freely distribute the URL identifying the publication in the public portal

If you believe that this document breaches copyright please contact us providing details, and we will remove access to the work immediately and investigate your claim.

This coversheet template is made available by AU Library
Version 1.0, October 2016
The role of the EU institutions in establishing the ESM
Institutional leadership under a veil of intergovernmentalism

Sandrino Smeets, Alenka Jaschke1 and Derek Beach

Abstract
This paper traces the role of the EU institutions in setting-up the ESM. There have been many scholarly assessments but few empirical reconstructions of the decision-making on the intergovernmental ESM, and its predecessor the EFSF. The instruments clearly constituted a step away from supranational entrepreneurship and the Community method. However, we question an intergovernmentalist interpretation in terms of institutional competition and decline. Using a historical analogy of the Delors model(s), we identify two types of institutional leadership, and show how the ESM was characterized, first by an uneasy combination and then a shift from political championship to the engineering type. In two case studies, we trace the negotiations about increasing the size and scope of the ESM. The analyses show that this was a rather bottom-up process, in which the institutions were laying out the tracks and providing the link between 'control room' (European Council) and 'machine room' (Eurogroup/EWG/TFCA) proceedings.

Key words
European Stability Mechanism, Economic and Monetary Union, EU institutions, European integration, leadership.

Address for correspondence:
Sandrino Smeets, Institute for Management Research, Elinor Ostrom building 03.369, P.O. 9108, 6500 HK, Radboud University Nijmegen. s.smeets@fm.ru.nl

Acknowledgement
This work is part of a research project supported by the Danish Council for Independent Research under Grant DFF-4003-00199. We would like to thank the editors and anonymous reviewers for their valuable comments and suggestions

1 At the time of writing, principal policy advisor, Council of the European Union, Office of the Chair of the EWG. The views expressed are solely those of the author and may not be regarded as stating an official position of the Council of the European Union.
Introduction

This paper contributes to the ongoing debate about the role and influence of the EU institutions in managing the Eurozone crisis and EMU reform process (Bauer and Becker, 2014; Fabbrini, 2013; Hodson, 2013; Jones et al, 2016). We provide an in-depth process tracing analysis of the setting up of the European Stability Mechanism (ESM) and assess the ability of the institutions to provide leadership in the negotiations. As many reconstructions of the Eurozone crisis have shown, the institutions were struggling to provide such leadership, particularly in the early years of the crisis (Bastasin, 2012; Pisani-Ferry, 2014). Among insiders, there is the persistent image of the Commission ‘dropping the ball’, and the European Council President ‘drowning in his ambitions’ (Interview A, B). Many scholars have acknowledged that the EU institutions had to adapt to a ‘constraining environment’, in which EU negotiations are highly salient in many member states, and touch upon ‘core state powers’ (Genschel and Jachtenfuchs, 2014; Hooghe and Marks, 2009). Some of the early literature spoke in terms of competition between the intergovernmental and Community method and a decline of the Commission in particular, now operating under the shadow of the European Council (Chang, 2013; Mény 2014). Others framed it in terms of a shift from classic entrepreneurship to policy management (Becker et al, 2016, p. 1014; see also Bocquillon and Dobbels, 2014; Nugent and Rhinard, 2016; Crespy and Menz, 2015), noting that the loss of agenda setting powers was compensated for by increased competences in the implementation and evaluation of fiscal and economic policies. Rather than looking for institutional influence elsewhere, this paper investigates how much ground the EU institutions actually lost in the negotiations as such.

There have been many scholarly assessments, but surprisingly few empirical reconstructions of the decision-making on the ESM, and its predecessor the European Financial Stability Facility (EFSF). There is of course no denying the intergovernmental characteristics of the EFSF and ESM, which are obvious from the fact that these lending facilities were established outside the EU's legal framework. It is equally clear that the main political decisions were made by the member states. The EFSF and ESM clearly constituted a step away from classic supranational entrepreneurship, in the sense of hard law and the Community method. In one of the few empirical papers on the ESM, Gocaj and Meunier

---

2 Within the context of this study on EMU, the term EU institutions refers to the European Commission, the (Secretariat of the) Council of the European Union, the European Council President and his cabinet, the EFC/EWG Secretariat, the TFCA Secretariat and the European Central Bank.
explain how an intergovernmental format triumphed over a Commission-led facility. Decision-making – particularly in the fateful weekend in May 2010 when the EFSF was set up as a special purpose vehicle (SPV) – was driven by (key) member states. European Council President Van Rompuy played a marginal role, while Commission President Barroso was ineffective, staunchly advocating a Community-based stabilization fund even after he was repeatedly rebuffed by Chancellor Merkel (Ludlow, 2010, p. 31-34). Gocaj and Meunier argue furthermore that while the EFSF was a hasty creation, it locked in an intergovernmental format that was subsequently replicated in the ESM (Gocaj and Meunier 2013, p. 251). The conclusion seems to be that when the institutions lost this battle, they effectively lost the war.

This paper provides a different take on these matters. First, we argue that if we shift the focus from the outcomes that key member states (Germany, Finland and the Netherlands) managed to avoid (such as a banking license for the ESM, a broader base for secondary market interventions and (initially) direct recapitalization of banks), to the process behind it, we will see that the member states were caught up in a bottom-up process about enhancing the EFSF and ESM, for which the institutions were providing the impetus. Second, we believe that some media sources and scholarly evaluations have put too much emphasis on the (generally limited) ability of individual presidents or institutions to steer developments at the European Council level (what we will call ‘the control room’). Our analysis will focus on institutional influence in ‘the machine room’, which ranges from the ministers to the civil servants. Moreover, instead of looking at the role of individual institutions, we look at their joint efforts in process management. While we completely agree with Gocaj and Meunier in their assessment of the May 2010 dynamics, we argue that it did not lock in a particular approach. Rather, it led to new patterns of inter-institutional cooperation, through which the institutions were able to provide a different, ‘engineering’, type of leadership, in which the institutions were able to lay out the tracks along which the decision-making could proceed.

We proceed as follows. In the next section, we re-assess dominant notions of institutional leadership, starting from the prevalent image of the ‘Delors-type’ of leadership. We use this historical analogy to make an analytical distinction between types and levels of leadership. Our empirical analysis consists of a comprehensive overview of the role of the institutions
in the ESM process and two in-depth case studies: the first about increasing the scope (flexibility) and the second about increasing the size (capacity) of the fund. The analyses show that the ESM negotiations were characterized first by an uneasy combination and then a shift from the first (political champion) to the second (engineering) type of leadership. In the conclusion, we discuss some of the implications and limitations of these types of institutional leadership.

**Analytical framework: types and levels of institutional leadership**

Leadership, whether by an individual or an institution, remains an elusive concept. In classic EU integration theory, institutional leadership is generally equated with supranational entrepreneurship (Haas 1958; Moravcsik 1999). Leadership then refers to the ability to drive the machinery forward towards a relatively clearly defined goal, of the type supposedly provided by the Delors Commission in the run-up to the Single European Act and the Treaty of Maastricht (Beach 2005; Pollack, 2003). Over the years, the Delors type of leadership has become a somewhat unfortunate model of a power-hungry Commission ‘hard wired to pursue ever closer union’ (Peterson 2015, pp. 187-188). We argue that there are in fact two Delors models, one that is often misunderstood as effective institutional leadership – which is the political champion model - and one that is commonly overlooked – which we call the engineering model. The confusion originates in a tendency to conflate the role played by the Delors Commission in 1991 with the influence of the Delors Commission in 1985.

With regard to the 1985 Intergovernmental Conference (IGC) leading up to the Single European Act, it would be wrong to treat this as a pure case of Commission leadership. The key to success was the close collaboration between the Commission, the Council Secretariat and the Luxembourg Presidency. At the control room level, the Commission President did not try to act as an equal partner of governments, but instead functioned more as a facilitator, sounding out governments on the type of reforms in which they might be interested (Grant, 1994, p. 66). The Commission helped frame the agenda for the IGC in 1985 by convincing the Heads of State or Government (HOSG) to put the White Paper of legislative reforms on the European Council agenda. President Delors fed leaders with detailed information about how things currently worked, rather than maintaining that the Commission’s way was the only way forward (Budden, 2002, pp. 81,90; Ross, 1995). At the
machine room level, the Luxembourg Presidency informally delegated most of the tasks to the Commission, in particular drafting texts in key policy areas (Beach, 2005, pp. 53-58). While formal agenda management was in the hands of the rotating Presidency, the Commission and Council Secretariat were invited to formulate solutions in key areas of the IGC (e.g. the definition of the Internal Market, on flanking measures such as environmental and social policies), and the institutions were actively involved in brokering compromises.

In contrast, in the 1991 IGC that negotiated Economic and Monetary Union (EMU) and Political Union, the Commission shed its cloak of technicality and instead attempted to act as the sole ‘champion of Europe’. At the control room level, it tried to put issues on the agenda through high-profile advocacy (Dyson and Featherstone, 1999, pp. 692, 702). President Delors personalized the project, and was seen as fighting for positions that were far outside what governments wanted. At the machine room level, the Commission even rejected the invitation by the Luxembourg Presidency in early 1991 to take part in the drafting of texts. Instead it attempted to openly advocate its own pro-integrative positions, infamously colluding with the Dutch Presidency in tabling a highly ambitious draft Treaty that was rejected by other governments (‘Black Monday’). The Council Secretariat still played an important facilitative role, assisting the Luxembourg Presidency in drafting a more feasible alternative. The Commission was able to stage a small comeback during the end-game, where it assisted France in brokering a compromise on EMU (Dyson and Featherstone, 1999, p. 737). Still, the overall impact of the institutions on the course of the negotiations was more limited than in 1985. At the end, Delors was reduced to grumbling publicly about the lack of progress and ambition in the negotiations (Beach, 2005, pp. 103-104).

This, admittedly highly condensed, historical analogy is very useful for analytical purposes. First, because it highlights the fact that what is often called Commission leadership is actually the product of intensive inter-institutional cooperation. Second and more importantly, it allows us to separate the type of leadership from the level at which this type is displayed. With regard to types of institutional leadership, an important distinction is often made between ‘transformative’ and ‘transactional’ leadership (Tömmel, 2013, p. 793; Ross and Jenson, 2017). When talking about major EU reform negotiations, transactional leadership essentially comes down to effective process management: chairing meetings,
drafting documents and managing agendas. This is the kind of leadership that supranationalists and neofunctionalists seem to be speaking of with the term ‘upgrading the common interest’ (Haas, 1961: 368) by increasing the overall efficiency and scope of the final deal beyond the lowest-common-denominator. While this type of leadership is generally more likely to be effective in increasing the efficiency of outcomes, the overall impact of the institutions (in distributive terms) tends to be limited. Transformative leadership, on the other hand, comes down to having a substantive (i.e. distributive) impact on the course and outcome of these negotiations. This is the kind of leadership that liberal intergovernmentalists seem to have in mind, which would reveal itself in major distributive shifts in the outcome on key aspects of the interstate bargains, in line with the preferences of these institutions (Moravcsik, 1999). If effective, political championship results in the institutions having a significant impact.

However, as Hodson (2013, pp. 301-302) rightly notes, there is still considerable debate about how often such leadership has succeeded, even in the days of Jean Monnet or Jacques Delors. What is clear is that in the post-Maastricht era, the possibilities for providing transformative leadership are even more limited. As the EU has moved into more sensitive and salient issue-areas such as fiscal policy or economic governance, its member states have become more wary of transferring competences, and the Community method has had to give way to governance by means of intergovernmental coordination (Bickerton, Hodson and Puetter, 2015, p. 703; Fabbrini, 2013, p. 1005; Mény 2014, p. 1340). This shift warrants a reassessment of institutional leadership strategies. New intergovernmentalism (NI) highlights some of the main implications for the supranational institutions. The institutions had to come to terms with two developments: the rise of the European Council and the entrance of a permanent European Council President, and the increased use/involvement of alternative actors and action channels, which in NI are called ‘de novo bodies’ (Peterson, 2015, p. 193; Puetter, 2015, p. 180). This has forced the Commission to become more ‘strategic’ and ‘pragmatic’, by making sure that it does not get ahead of the member states, and by establishing new patterns of inter-institutional cooperation across the intergovernmental-supranationalist divide (Peterson, 2015, p. 203). So far, NI has focused primarily on the control room level, for instance determining the influence of the Van Rompuy-Barroso tandem, noting that the former was generally unwilling and the latter
unable to act as ‘the engine’ (Hodson, 2013, pp. 311-312; Howarth and Quaglia, 2015, p. 147; Puetter, 2015, p. 174).

The distinction between levels teaches us that there are essentially two ways in which the institutions can have such a significant impact (See Table 1). The first one is through political championship in the control room, the second one is through engineering (laying out the tracks) in the machine room. The second way is usually less visible, as it is focused on the preparatory and follow up stages of the decision-making, in which the institutions are busy with drafting proposals, brokering compromises and finding creative solutions, while working within the framework of the deals reached at the higher level. The impact that this type of leadership can have is reflected in the terminology of ‘laying out the tracks’. Those who lay out the tracks have a major impact on what the journey will come to look like, even if they do not determine the final destination and are dependent on the member states to see how far they are willing to travel along a certain track.3

There is a fourth option, in which the institutions are only able to provide transactional leadership in the machine room. One could wonder whether this can be considered leadership. To be clear, the institutions still play a role, because without their involvement a deal might not be reached at all. However, it is clear is that the impact of the institutions is most limited here, and focused almost purely on efficiency gains, as they mainly assist the member states in fleshing out the details of the deals that they reached at the higher level.

Table 1: types and levels of institutional leadership

<table>
<thead>
<tr>
<th>Level/Type</th>
<th>Transformative leadership</th>
<th>Transactional leadership</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control Room</td>
<td>Political championship</td>
<td>Upgrading the common interest</td>
</tr>
<tr>
<td>Machine Room</td>
<td>Laying out the tracks</td>
<td>Efficiency gains</td>
</tr>
</tbody>
</table>

The distinction in types and levels allows us to make a more fine-grained assessment of what is new about institutional leadership in a constraining environment. Two implications

3 Although there might be more than one track along which negotiations can proceed, the number of tracks is usually limited, which points to the influence of ‘the engineers’ in coming up with feasible alternatives.
stand out: institutions have to cope with a control room providing instructions and having a veto over certain policy options (see Bocquillon and Dobbels, 2014, p. 22) and they have to deal with usually longer, more flexible and partly informal, chains of delegation, in our case from the European Council to the Eurogroup, to the Eurogroup Working Group (EWG), to the Task Force on Coordinated Action (TFCA). In the case studies, we analyse the varying interplay between the control and machine room over time. In the control room, the Heads were unable to provide all leadership functions themselves, due to lack of time and technical expertise. In the machine room, the finance ministers were unwilling to provide all leadership functions without there being clear instructions from the HOSG that provided them with legitimacy to agree on far-reaching reforms. The institutions played a key role in linking these control and machine room proceedings. We discern two patterns. The control room can be used to push machine room negotiations forward, or to mandate negotiations on new issues. Alternatively, it can work the other way around, whereby the machine room can be used to start discussing matters before there is the political willingness to deal with them in the control room. We will see examples of both in the case studies.

**Empirical analyses: Increasing the size and scope of the ESM**

In this section we analyse the role of the EU institutions in the decision-making on the main features of the ESM. There were simultaneous negotiations about enhancing the existing temporary lending facility (EFSF), that spilled over into the ESM debate, which will be included in the analysis. The ESM is a permanent fund that can provide loans to Eurozone countries facing problems financing their debt. After amending Article 136 of the Treaty on the Functioning of the European Union (TFEU) to allow for the creation of the ESM, the ESM itself was created by an intergovernmental Treaty. Agreement on the first version of the Treaty was reached in June 2011. Yet due to the crisis - specifically problems with agreeing on a second programme for Greece - the Treaty had to be adjusted before it came into force. The second version of the Treaty was finalized at the end of January 2012 (European Council, 2012b). The four main issues for debate were:

- **Size** of the fund(s) and the form in which member states are to provide the capital (paid-in capital, callable capital, guarantees or loans) and ways to increase the capacity (leveraging, banking license, access to the Eurosystem).
- **Scope** of the fund(s): the instruments available or activities the fund(s) are allowed to engage in, apart from granting loans (precautionary programs, (in)direct recapitalization of banks, primary and secondary market interventions).

- **Terms and conditions**: the interest rates, maturity, and general conditions for providing financial assistance to a member state.

- **Decision-making procedures**: how member states decide on disbursements and the role of the institutions in launching such a decision and in monitoring.

On the third and fourth issue, much had already been decided in 2010, and some of the modalities for the ESM were taken over from the EFSF. The case studies thus focus on the first and second issue for debate. The first is about increasing the scope (or flexibility) of the EFSF and ESM, which lasted roughly from January until July 2011. The second traces the negotiations about increasing the size (or capacity) of the ESM, which lasted roughly from September 2011 until March 2012. The analysis is based on first-hand observations. Next to publicly available data such as European Council Conclusions, Euro Summit and Eurogroup Statements, Commission documentation and press reports, we rely to a considerable degree on insider recollections and in-depth interviews. The authors were personally involved in the decision-making and/or have held multiple rounds of conversations with other key participants from the member states and institutions. We corroborated these insider recollections with evidence that is publicly available.

As we mentioned in the introduction, the first stage was characterized by an uneasy combination of political championship and engineering. Previous analyses have highlighted Commission President Barroso’s rather unsuccessful attempts to act as ‘the sole true champion of the community method’, which resulted in turf battles with the European Council President and a rather difficult relationship with the German Chancellor (Ludlow, 2010, pp. 53-55). It is no secret that one of the main reasons why this competence was not given to the Commission was due to German hesitance. Less well-known, but more telling from the perspective of institutional leadership is what happened immediately afterwards. Resembling the behaviour of Delors in 1991, Barroso was unwilling to consider a more modest role for the Commission within this intergovernmental framework. The Commission

---

4 See the online appendices, which contain a chronological overview of the ESM negotiations and a table with a comprehensive overview of the role of the institutions on all four bargaining dimensions.

5 Using the words of Federal Chancellor Angela Merkel in her ‘union method’ speech, Bruges 2-11-2010.
had been tasked with managing the Greek Loan Facility (GLF) and many expected that it would be the same with the EFSF (Interview C, D, I). While the services were preparing for this, the political level backtracked, which resulted in the intergovernmental structure based in Luxembourg. Insiders acknowledge the tensions within the Commission at the time:

‘For the political level it was difficult to agree to operate in a format that was not accounted for in the Treaties. Purists within the Commission felt that DG Ecfin had to stretch its mandate quite a bit to be able to put their manpower and expertise at the disposal of these intergovernmental structures.’ (Interview C)

At the services level, however, there were fewer inhibitions to working within the intergovernmental column. The main action channel was the Task Force on Coordinated Action (TFCA), which had been created to set up the GLF and would be dealing with all EFSF and ESM modalities. The TFCA would typically receive its instructions from the Eurogroup Working Group (EWG), which would deal with the more political issues, before they reached the Eurogroup. In the ESM process, the main role of the EWG was to channel issues up to the ministers or (back) down to the TFCA. Institutional cooperation between the different levels had already been established, running from the European Council President’s cabinet down to the EWG and TFCA structures (Interview, E, F, G, H). Much of this had started even before the GLF was set up, and was done in a rather ad hoc and informal manner, as part of technical reflections. The initiative was with the Chairs of the TFCA and the EWG, but much of the preparatory work was done by the staff from DG Ecfin, even though these drafts would be presented as proposals by the respective Chair rather than as Commission notes. This approach would be replicated for the EFSF and the ESM process.

**Case study 1: increasing the scope (flexibility)**

The negotiations on increasing the scope of the EFSF and ESM preceded the debate about the size. The subsequent analysis explains the significance of the institutions in this process. The role of the institutions was characterised by drafting key proposals that formed the basis for the debate, brokering compromises on intermediate solutions that prepared for
the next step, and coordinating the interplay between the two levels, (pre)designing solutions in the machine room and obtaining political endorsement from the control room.

The machine room debate about the different instruments was confined to the first three months of 2011, awaiting political decisions at some later stage. There was no explicit mandate – in terms of European Council Conclusions or Eurogroup Statements – for the TFCA and EWG to start discussing other instruments. Up until the end of 2010, the HOSG and finance ministers had focused only on the major political decisions regarding the terms and conditions. The impetus to talk about the scope primarily came from the Commission and the Chair of the TFCA. The TFCA had one meeting about the subject in January, five in February and one in March. In that same period, the EWG had three meetings and three conference calls in which the different instruments were discussed, in the context of a ‘comprehensive response’ to the Euro crisis.

From the perspective of the more hesitant member states, Germany, Finland and the Netherlands, it is noteworthy that they were willing, or at least unable to avoid, negotiations about instruments that they did not really care for in the first place. To some extent, it was the prerogative of the Chair of the TFCA to put these issues on the agenda and invite the Commission to provide input on them, as long as there were a sufficient number of other member states that wanted to say something about them (Interview, C, E). Moreover, national delegates at the working party level are typically not in a position to categorically rule out certain options or refrain from general reflections. Still, the TFCA was effectively pre-designing solutions that the political level was unwilling to consider at this point in time.

The funds were originally intended only to provide emergency loans, accompanied by a macroeconomic adjustment program. From the outset, the Commission and ECB had wanted the funds to be larger and to be able to do more (Reuters, 2010a, 2010b). In its contribution to the work of the Task Force on Economic Governance in June 2010, the ECB had already suggested that a crisis mechanism should include ‘purchases of government debt securities issued by a Member State in distress’. Instead of providing a country with a loan that would then primarily be used to honour that country’s obligations to the

---

6 ‘Reinforcing Economic Governance in the Euro Area’ European Central Bank, 10 June 2010: p 12.
bondholders, the EFSF and later ESM would be able to buy that country’s bonds directly at market prices. However, at the time, the control room did not provide the go-ahead for such (secondary) market operations. Another new instrument would be a precautionary credit line.7 The idea had first been raised at the EWG level in November 2010, in relation to the EFSF programme for Ireland. On 16 November the Eurogroup acknowledged that the EFSF could in principle be used as a precautionary instrument, but instead a full programme was agreed on 28 November. However, at the TFCA level, the option was further explored, with the debate focusing on the appropriate level of conditionality.

In late January and early February 2011, the Commission presented the TFCA with a series of ‘option papers’ in which the basic features of possible instruments were presented along with their advantages and disadvantages (Commission, 2011).8 These papers served to flesh out the modalities, frame the possible choices and make ambitious outcomes appear less so. Besides the precautionary credit lines and primary and secondary market purchases, some more radical options were included, such as guarantees given by the ESM to beneficiary member states and so-called ‘bond swaps’, in which the EFSF/ESM would buy up a country’s debt in the open market and trade it back to the government for new bonds.9 Next to these radical options, the option papers also included a number of intermediate solutions. One of the less controversial instruments mentioned were primary market purchases, basically because there is not a big difference between providing a loan to a country and buying its newly issued bonds. Even within the Commission, some felt that this instrument would not be very useful, but others thought it could play a modest role in helping a ‘borderline’ country to stay in the markets or help it to re-enter (Interview J). More importantly, it would anchor the principle of EFSF/ESM engaging in market operations.

This intermediate step was important because there were still objections to the secondary market purchases. This was not only due to perceived incompatibility with the spirit of the no-bail-out clause, but also because several member states were sceptical about the utility

7 The instrument of ‘a standby-loan’ came from the IMF toolkit, where it had been used on previous occasions (for instance Argentina) in an attempt to prevent the actual (disbursement of a) loan.
8 One of the first papers, ‘reflections on a possible European Stability Mechanism’, European Commission, Brussels 13-01-2012 formed the basis for the TFCA meeting of 25 January 2011.
9 The Council Legal Service concluded that the last two options were incompatible with Article 125 TFEU.
of these operations. In fact, not even the Commission was a fan of the instrument, however it supported the ECB in its quest to replace the Securities Markets Programme (SMP) (Reuters, 2011a). On the basis of Commission proposals, the TFCA was able to develop the general outlines for what such a mechanism could look like. Delegates were still trying to determine what effect such operations would have on markets and on the credit rating of the beneficiary member states. However, the TFCA Chair opted for an approach which had been developed in relation to the GLF, that allowed for the process to proceed in spite of these hesitations. The machine room would first seek a general agreement on the principle, which would then be laid down in a so-called ‘term sheet’ (European Council, 2011a). This term sheet would be endorsed by the EWG and Eurogroup, after which the TFCA could start dealing with all the legal and technical details.

The range of instruments presented to the Ministers by the EWG on 14 February 2011 thus included loans, primary and secondary market purchases and precautionary credit lines. The ministers failed to reach an agreement, so the decision had to be taken by the HOSG at their summit of 11 March, where only loans and primary market purchases were endorsed. While the Heads did not endorse a precautionary credit line, they also did not rule it out, and there were some attempts to revive the discussion at the ministerial meeting of 14 March 2011. More relevant was the inclusion of the passage that was later to become Article 16 in the (first version of the) ESM Treaty:

> The Board of Governors may review the list of financial assistance instruments provided for in Articles 14 and 15 and decide to make changes to it (European Council, 2011b).

This Article, again agreed at TFCA level, created the opportunity to include the other instruments at a later stage, without having to re-open the Treaty. In the period between mid-April and mid-May, the TFCA ploughed through eleven versions of the draft ESM Treaty. The debates resembled the typical ‘drafting exercises’ we know from normal Council meetings, with the Commission defending the draft, while member states requested

---

10 Internally, the Commission was not convinced that the ESM would ever be able to take over from the ECB. This would require very strong credibility and unlimited firepower, at the time it had neither.


changes. All this time, the secondary market operations and precautionary assistance remained on the table, but the machine room could not force through a decision from the political level, without there being an immediate crisis to solve. However, when that need came in July 2011, the ground was prepared for quick agreement on the two remaining instruments.

We see a similar approach, but within a much shorter time span, with regard to the fourth new instrument: the ability to provide financial assistance for the recapitalization of financial institutions. Again, a relatively uncontroversial intermediate option was included, namely the *indirect* recapitalization of banks via their sovereign. This idea, which supposedly came from the Commission but was first mentioned in an EFSF flexibility paper, was touched upon in two EWG conference calls preceding the Euro Summit of 21 July 2011. The ECB was obviously in favour, since a lot of banks had become reliant on the ECB for funding (Reuters, 2011b). But for the other institutions, it was mainly a way to anchor the principle of bank recapitalization, seeing that there was little progress - in fact little debate - about *direct* bank recapitalization (Interview E, G). In 2011, this was a bridge too far. The instrument of indirect recapitalization was briefly discussed during the joint EWG-Sherpa meeting, dominated by the private sector involvement (PSI) for Greece, before it was agreed by the Heads at the Euro Summit of 21 July 2011 (Ludlow, 2011a. p. 12). Direct recapitalization would be part of the grand bargain at the June 2012 Summit, as it required the political recognition of the presence of a ‘vicious circle’ between banks and sovereigns.

The first case study has shown how the machine room debates were able to set the scene for the control room decisions to increase the scope of the funds. The negotiations about the scope of the EFSF and ESM were basically finished in May 2011. The final step was to get the endorsement from the control room. European Council President Van Rompuy played his part by ‘convincing’ the hesitant Chancellor of the need to have yet another crisis summit (Agence Europe, 2011a). Summits create expectations and put hesitant government on the defensive. The secondary market interventions were a concession by Chancellor Merkel in return for a substantial PSI (Ludlow, 2011a, p. 7). This allowed the HOSG to agree: ‘to
improve the effectiveness of the EFSF and of the ESM...to increase their flexibility linked to appropriate conditionality' (European Council, 2011c)

Case study 2: enhancing the size (capacity)

The second case study analyses the process that led to the March 2012 decision to increase the capacity of the ESM. While the role of the institutions was essentially the same as in the debate about the scope - drafting key proposals, brokering compromises on intermediate solutions and acquiring endorsements from the higher levels - the interplay between the control and the machine room was different. What was different was that on the scope, the machine room had developed the solutions (long) before the control room took the actual decisions. On the issue of size, dossiers would move between the different levels at a much quicker pace, with the control room endorsing the general outlines of a solution before the machine room had been able to figure out the details of that solution.

The size and scope of the EFSF/ESM obviously constitute two sides of the same coin. However, effective negotiations about the former were postponed by focusing on the latter (Reuters, 2011c). At the TFCA level, it had already been mentioned at the beginning of 2011 that what was actually required to calm the markets and address all potential financing needs was something in the range of 900 to 1000 billion. But at the time, it was clear that for member states like Germany and the Netherlands, 500 billion, equivalent to the EFSF (and EFSM), was the absolute maximum, with the implicit understanding that the ESM would eventually come to replace the EFSF (Reuters, 2011d). The issue of how to handle the transfer from EFSF to ESM was deliberately kept off the agenda at this stage.

The debate about increasing the size resurfaced in the Autumn of 2011. The TFCA first discussed advancing the entry into force of the ESM by 1 year and allowing the 500 billion of lending capacity of the ESM to run independently from the EFSF, but several MS opposed the latter. The focus again shifted to creating intermediate solutions, which in this case meant finding ways to increase the capacity of the funds, without having to raise member states' contributions or guarantees. One option would be to allow the funds to engage in leveraging. Another option was to make the funds eligible to borrow at the ECB's regular

---

13 Statement by the Heads of State and Government of the Euro Area and the EU Institutions, Brussels 21-7-2011: Stabilization tools.
14 This was on 26 September, there was a second discussion on 18 October with the same result.
funding operations, something which was presumably to be done by providing the funds with a banking license (Reuters, 2011e).

The ‘debate’ about the banking license was limited to the control room, which explains why the idea never went anywhere. Here, it was pushed for by France and to a lesser extent Italy, but fiercely opposed by the ECB and Germany. It featured in one EWG conference call on 10 October 2011, but it was immediately discarded because it breached Article 123 TFEU prohibiting monetary financing. From an institutional perspective it was a non-debate (Agence Europe, 2011b). The real issue was not the bank license, but access to the refinancing facilities of the Eurosystem. It was the ECB that granted access to the Eurosystem; it was not something the member states could decide on. As much as the Commission loved the idea, it could not table proposals on it, out of respect for the ECB’s independence (Interview I, K). This explains why the issue was never on the agenda of any TFCA, EWG or Eurogroup meeting.

In contrast to the bank license and access to ECB funding, there were real negotiations about leveraging, both in the control and the machine room. The idea, which had been floated by US Treasury Secretary Timothy Geithner when he visited the Eurogroup, was briefly discussed during an EWG conference call on 10 October 2011 (Reuters, 2011f). However, before the TFCA could even work on it, the debate was already taken up to the level of the Eurogroup and the Euro Summit. Seeing that the technical work was not advanced enough to present the ministers with a final proposal to endorse, the Eurogroup could only pass the matter back to the EWG, a week before the HOSG were set to discuss the matter. At the Euro Summit of 26 October, the Heads nevertheless agreed to a leveraging effect of ‘up to four or five’ times the size of the fund (European Council, 2011d). More importantly, they provided their finance ministers with homework for November. The Eurogroup was subsequently able to deliver the two leveraging options at their meeting of 29 November 2011 (Reuters, 2011g). This decision, however, did not end the debate about the size. Germany was very much in favour of the form of self-leveraging that the EFSF in particular was propagating, but many had doubts that it would generate enough interest on the markets (Interview L, Eurogroup, 2011). The ministers still endorsed it, but with the

---

15 Euro Summit Statement, Brussels, 26-10-2011: 19-22
16 Eurogroup press conference by President Juncker and EFSF President Regling 7-11-2011.
understanding that it would probably not bring the four- or fivefold increase pledged by the Heads. The most telling evidence for this is that at this very same meeting, the Eurogroup started to explore other ways to boost the funds, specifically by raising their IMF contributions (Reuters, 2011h).

Now that other avenues had been tried, the institutions could circle back to what initially had been framed as the most straightforward solution, which was to allow the EFSF and ESM to run in parallel. In this final round of the debate, the institutions were able to manage the interplay between control and machine room most effectively. The TFCA Chair reported to the EWG on 5 December that the TFCA had been unable to reach an agreement to lift the ceiling. The EWG Chair then suggested to have a statement by the euro area HOSG that the adequacy of the combined ceiling would be reassessed at a later stage. In the interim report that European Council President Van Rompuy presented to the HOSG, it was carefully framed as keeping the combined lending capacity ‘open for review’ (Reuters, 2011i). The statement adopted by the Heads on 9 December spoke of a need to ‘reassess the adequacy of the overall ceiling of the EFSF/ESM of EUR 500 billion’ (European Council, 2011e). With Eurobonds and an ESM bank license as alternatives, Chancellor Merkel could again frame a potential enhancement of the capacity (and an acceleration of pay-ins) as an acceptable concession (Ludlow, 2011b, p. 28).

The Euro Summit again provided the Eurogroup with a strict deadline, March 2012, for fleshing out the modalities. The EWG had two meetings on the matter in February, on the basis of option papers presented by the Commission. The main point for debate was whether to combine the full ESM capacity only with the used EFSF capacity (resulting in a capacity of around 700 billion), or to combine the full capacities of both funds (raising the capacity to 900 billion) (Agence Europe, 2012). In the meetings, a couple of member states stated that they were unwilling to deal with the increased lending capacity at the ministerial level, before the Treaty on Stability, Coordination and Governance (TSCG or ‘Fiscal Compact’) was signed, which would be in the margins of the European Council of March. In the Summit statement, drafted by the cabinet of President Van Rompuy, the Heads reminded the Eurogroup that a deal needed to be reached by the end of the month.

---

17 Statement by the Euro Area Heads of State or Government, Brussels 9-12-2011: Strengthening the stabilization tools, 14. A reference to this agreement was also put in a recital in the ESM Treaty.
Another EWG meeting was needed on 22 March, where it was agreed that the EWG Chair would put forward a compromise proposal to the Eurogroup meeting in Copenhagen on 30 March, which was then adopted.

The second case study illustrates the implications of having more active control room involvement, and longer and more flexible chains of delegation. The control room still decided on the final destination. The end-result, predictably, was a compromise closer to the German position. The member states agreed to increase the overall capacity (of EFSF and ESM combined) to 700 billion and to accelerate the transfer of paid-in capital (Eurogroup, 2012). In the debate about the size and scope, there were five such occasions, in March, July, October and December 2011, and March 2012, in which HOSG were put in a position where they were asked to make concessions. The institutions obviously did not force member states to make these concessions, but ‘merely’ suggested what these concessions could look like. However, if we look at how the dossier travelled between the four levels, TFCA, EWG, Eurogroup and European Council, the hand of the institutions becomes visible. The ‘track’ that led to an enhancement of the size of the ESM was laid out in the second half of 2011. In the months that followed, the institutions carried the negotiations back and forth between these levels, using the control room to spur on the machine room (such as in October 2011), or using the machine room to take matters up to the control room (such as in December 2011).

**Conclusion: limitations and implications for institutional leadership**

This paper has provided a detailed reconstruction of the decision-making on the main features of the ESM. The EFSF and ESM have been extensively covered, but much of this coverage and subsequent assessments has been limited to high level politics. From an institutional perspective, these can be considered as the tip of the iceberg, while much of the institutional efforts shifted to politics occurring below the waterline (the machine room). We are not suggesting that this was all part of a cunning scheme to provide institutional leadership ‘by stealth’. If anything, the ESM was a case of learning the hard way about how to operate within the confines of the new inter-institutional set-up. Although we have tried to show that some of the impediments to supranational entrepreneurship were also present.

---

18 Statement Euro area Heads of State or Government, Brussels 02-03-2012.
19 Statement of the Eurogroup, 30-03-2012
in the days of Delors, we acknowledge two new, or at least more prominent, elements: more active control room involvement, and longer and more flexible chains of delegation.

We should note a few other limitations for institutional leadership. First, by focusing our analyses on the size and the scope of the funds, we might be accused of ‘cherry-picking’. We admit that the institutions played a more modest role in determining the terms and conditions under which the funds could operate.20 A large part of these terms and conditions (the macro-economic adjustment programmes, the IMF involvement, the preferred creditor status and the link to the TSCG) resulted from direct intergovernmental bargaining. Second, we need to acknowledge the fact that decision-making was very much event driven. All enhancements of the EFSF and ESM originated from crisis summits (May and October 2010, July, October and December 2011), which took place amidst significant market pressure. Third, there was no strong spill-over effect, fitting with neofunctionalist interpretations, whereby the institutions were able to use previous (incomplete) steps in the ESM trajectory to induce the next one (Niemann and Ioannou, 2015). On the other hand, we have tried to qualify historical-institutionalist notions of lock-in and path-dependency, because these approaches tend to overlook the fact that these paths are generally created by the institutions, using the events (Gocaj and Meunier, 2013).

Moving from limitations to implications, we have argued that the institutions were able to provide a different type of institutional leadership – an engineering type – that is tailored to the constraining environment in which the negotiations took place. We looked beyond individual institutions and images of (control room) decline, but rather assessed their joint efforts to manage the (machine room) proceedings. None of the institutions were able to completely oversee, let alone control, the journey, but they were jointly able to lay out the tracks along which negotiations could proceed; with the Commission and EFSF drafting proposals that went beyond the initial political agreements, the TFCA, EWG Chairs and Secretariats brokering compromises on intermediate deals, which set the scene for the next round of debate, while the European Council President and cabinet ensured the timely endorsements from the control room.

---

20 With regard to the fourth bargaining dimension, the decision-making procedures, quite a number of elements were taken over from the GLF, EFSF and therefore not really decisions at all. See appendix III.
We end on a general note. There is no denying that EU decision-making, crisis and post crisis, has become more informal, ad hoc and intergovernmental. This requires from the institutions a greater level of flexibility in responding to immediate challenges. However, this need for flexibility also creates room for autonomy. These observations regarding types and levels of leadership obviously need to be corroborated for other issue-areas. But our suggestion would be look beyond the formal competences of visible leaders and take into account what ‘Sir Humphrey’ is doing. To use a familiar dictum in EU politics: 'The thicker the fog on the mountain, the greater the need for a guide' (Bostock, 2002, p. 232).

References


21 Sir Humphrey was the cabinet Secretary in the BBC series ‘Yes Minister’ and ‘Yes, Prime Minister’.


Ludlow, P. (2011b) 'The European Council of 8/9 December 2011’
**Interviews**

The interviews that were used for this paper were conducted as part of a large scale research project on new institutional leadership, conducted in close cooperation with the EFC Secretariat (Stefan Pflüger), the Council Secretariat (Olaf Prüssmann). Since 2014, more than one hundred interviews have been conducted by the authors. More information on these interviews is provided on the website of the first author. Below, we only list the interviews that we explicitly refer to in the text.

Interview B with member states representative, Brussels, 20 May 2015.
Interview C with TFCA and Commission official, Brussels, 7 June 2017.
Interview D with member state representative, Brussels, 18 October 2014.
Interview E with member of EWG & General Secretariat of the Council, Brussels, 9 July 2015.
Interview F with member European Council President cabinet, Brussels 17 November 2015.
Interview G with member European Council President cabinet, Brussels, 14 July 2015.
Interview H with Commission official, Brussels, 27 August 2015.
Interview J with Commission official, Brussels, 9 July 2015.
Interview L with ESM representative, Luxembourg, 21 June 2017.

**Press reports**

Agence Europe (2011a) ‘Doubts about eurozone summit this week’, 14 July.
Agence Europe (2011b) ‘Enhanced EFSF up and running’, 15 October
Agence Europe (2012) ‘Ministers expected to decide on financial bailout funds’, 29 March
**Reuters (2010b) ’EU’s Barroso: European stability fund can be improved’, 15 December:**
**Reuters (2011b) ‘ECB’s Stark: EFSF could buy bonds, recapitalize banks’ 22 January**
**Reuters (2011c) ‘German FinMin says too early for bail out boost talks’ 13 January**
**Reuters (2011d) ‘Comments by EU officials, finance ministers’ Reuters, 18 January.**
**Reuters (2011e) ‘Trichet-Not appropriate for ECB to leverage EFSF’, 6 October**
**Reuters (2011f) ’EFSF leveraging idea discussed-euro zone officials’ Reuters, 16 September**
Reuters (2011g) ‘Eurogroup set to fix EFSF leveraging rules, deal with Greek aid’ 29 November
Reuters (2011h) ‘Euro zone ministers agree to quickly boost IMF resources’, 29 November
Reuters (2011i) ‘Euro zone leaders may raise ESM, EFSF capacity limit’, 6 December

**EU Documents**

European Commission (2011) *Reflections on a possible European Stability Mechanism*
Brussels, 13 January 2012.


European Council (2012a) *Statement Euro area Heads of State or Government*, Brussels, 2 February 2012.

European Council (2012b) *Treaty establishing the European Stability Mechanism (2nd version)*, Brussels, 2 February 2012.

Eurogroup (2011) *Press conference by President Juncker and EFSF President Regling*
Luxembourg 7 November 2011.

Appendix I: Chronological overview of the ESM negotiations

The negotiations about the main features of the ESM effectively lasted from May 2010, when the need for a permanent fund was first acknowledged, to March 2012, when the decision was taken to enhance the capacity and accelerate the build-up of the fund. Informal reflections about a permanent crisis mechanism started already in May 2010. When agreeing on the EFSF and EFSM, the EU finance ministers already mentioned the possibility of ‘establishing a permanent crisis resolution framework’. While the Eurogroup and Eurogroup Working Group (EWG) were still deciding on the modalities of the EFSF, they were aware that something more permanent would follow suit.

The development of an effective crisis mechanism was mentioned, albeit in rather general terms, as one of the four objectives, by the Van Rompuy Task Force on Economic Governance. However the Task Force would focus most of its energy on the strengthening of the Stability and Growth Pact (SGP). The Commission did mention in its communication of 12 May 2010 that it intended “in the medium-to-long term make a proposal for a permanent crisis resolution mechanism.” The ECB wanted this permanent fund to replace the Security Market Program (SMP), with the same underlying idea of driving down yields. But the matter was not discussed in the Task Force, and there was only a general reference to it in the final report: "The setting-up of a crisis resolution framework requires further work. As it may imply a need for Treaty changes, it is an issue for the European Council.” Impetus came from the Deauville meeting and a Franco-German paper on private sector involvement (PSI), which was discussed at the European Council of 28/29 October 2010. The institutions were quick to endorse the possibility of limited Treaty change to establish the ESM. The other Heads of State and Government followed suit.

The Eurogroup discussed the modalities of this permanent crisis mechanism at an extraordinary meeting on 28 November 2010. The outline was presented by the

---

22 Extraordinary meeting, Economic and Financial Affairs Council, Brussels 09/10-05-2010.
23 Remarks by Herman van Rompuy President of the European Council, following the first meeting of the Task Force on economic governance, 21-05-2010.
26 ‘Juncker: EU Treaty can be changed for rescue mechanism’, Reuters, 27-10-2010.
Commission, who said it had prepared it in close cooperation with the President of the European Council, taking into account previous discussions in the Eurogroup and the EWG. The mechanism would build upon the EFSF framework, would include private sector involvement on a case by case basis, and was to be launched by a unanimous decision of the Eurogroup. The December 2010 European Council endorsed these modalities and agreed to the minor Treaty change, included on the insistence of Germany, to highlight the compatibility of an intergovernmental ESM with the EU Treaty. The European Council called upon the Eurogroup to finalize work on this mechanism by March 2011. Some member states would have liked to see the negotiations on the six legislative proposals on economic governance (the six-pack) proceed at a similar pace, but that did not seem feasible, seeing the ad hoc working party that was to deal with the “six-pack” had only had its first meeting on 24 November 2010.

A first complication, which was the limited lending capacity of the EFSF, had become apparent as soon as technical details of the mechanism were worked out, but the issue was not publicly discussed in order to avoid negative market reactions. Already in the summer/early autumn of 2010, the Task Force on Coordinated Action (TFCA), and EWG had noted that the effective lending capacity was closer to 250 billion, rather than the 440 billion that had been originally envisioned. Possibilities for raising the capacity of the EFSF were discussed at several TFCA and EWG meetings up until January 2011, but no decisions were expected from the Eurogroup that month. A related problem was the statistical treatment by Eurostat, which did not consider the EFSF as an autonomous body but as a rerouting of government debt. In the period of January to March 2011, the TFCA and EWG were primarily working on the structural features of the ESM, which were due to be finalized by March 2011. The TFCA had one meeting in January, five in February and one in March; and the EWG had one meeting and two conference calls in January, one meeting and one conference call in February, and one meeting in March in which the new instruments were discussed (in the context of a ‘comprehensive response’ to the Euro crisis).

---

27 Statement by the Eurogroup, 28-11-2010.
28 European Council Conclusions, 16/17-12-2010: 3.
30 ‘EU/Eurogroup No new measures against the crisis’ Agence Europe 8-12-2010.
The March 2011 Euro Summit vowed to make the 440 billion of the EFSF fully effective. It called upon the Eurogroup to finish its work on both the EFSF and the ESM before the European Council of the end of the month. A third complication had become apparent, which was the high, even punitive according to some, interest rate that programme countries had to pay on a loan from the fund. The conclusions note that: ‘pricing of the EFSF should be lowered to better take into account debt sustainability of the recipient countries, while remaining above the funding costs of the facility, with an adequate mark up for risk, and in line with the IMF pricing principles’.32

The European Council of the end of March endorsed (without discussion) a term sheet on the ESM, that set out the contours of an agreement on the size, the terms and conditions (a.o the interest rates), and the general decision-making procedures.33 The term sheet was drafted by the EFC/EWG Secretariat. With regard to size and scope, the conclusions already mentioned the option of intervening in the primary markets, as well as the possibility to accelerate the provision of paid-in capital. At the lower levels, there had already been extensive negotiations about what more the funds could do (discussed under the heading of flexibility). Such activities were discussed within the context of the EFSF as well as the ESM. The Eurogroup+ (= Ministerial meeting on the European Stability Mechanism) format was used to work on the ESM.34 Meanwhile, the (regular) Eurogroup was working on how to enhance the EFSF and make the 440 billion effective, mainly through raising the guarantees. When agreeing to the programme for Portugal, the Eurogroup also agreed to raise the EFSF guarantees to 720 billion, thereby restoring the effective lending capacity of 440 billion.35 In June 2011, the Eurogroup+ formally agreed on the ESM Treaty, which was subsequently endorsed by the European Council in June 2011 and signed by the finance ministers at their meeting in July.

A new chapter in the debate about the ESM opened up immediately afterwards. As part of the negotiations about a second package for Greece (with PSI), there was a renewed call for

32 Conclusions of the heads of state and government of the euro area 11-3-2011: Financial conditions.
33 European Council Conclusions, Brussels, 24/25-03-2011; Annex II/ term Sheet on the ESM.
34 The participants to the ESM meeting members are its Chair (PM Juncker), a representative from each of the euro area member states, a representative from the ten non-euro area member states which had all announced their interest in participating, the Commission and the ECB.
35 ‘Euro bailout fund guarantees to rise to EUR 726 bln’, Reuters, 17-05-2011. The legal text would be finalized 20 June (after the elections in Finland).
making more flexible use of the EFSF and de facto also of the upcoming ESM. At the Euro Summit of 21 July 2011, HOSG agreed ‘to improve the effectiveness of the EFSF and of the ESM...to increase their flexibility linked to appropriate conditionality’. On paper, they created a couple of potentially far-reaching options and instruments: precautionary programmes, indirect recapitalization (of banks via the sovereign), the funds taking over from the ECB in using secondary market interventions to stabilize financial markets. Moreover, the interest rates for Greece (3.5%, equivalent to the Balance of Payment facility) would also be applied for Portugal and Ireland. In reality, these instruments had been around for a while. They had been part of the first working paper drafted by the Commission in cooperation with the TFCA Chair, presented to the TFCA in January 2011.

At the Eurogroup in September 2011, ministers further discussed some of the adjustments to the framework and lowering the interest rate. The details were again dealt with by the TFCA, with the October 2011 Eurogroup reflecting on their work. Meanwhile, at the political level, there were some discussions about a banking license for the ESM, but due to strong opposition by several members this idea was never developed in detail. The crisis summits of October 2011 led to further changes. There were intensive debates about enhancing the size of the EFSF and ESM (‘firewalls’), mainly through leveraging.37 The HOSG and their Sherpas, discussed and endorsed the two leveraging options themselves, albeit in general terms. The technical work was to be done by the TFCA and EWG. At the Eurogroup of 3 October, the finance ministers endorsed the earlier arrangements regarding the precautionary programmes, indirect recapitalization and secondary market interventions, although a formal decision could not be taken because some member states were awaiting parliamentary approval. At the Eurogroup of 7 November 2011, the process of signing the ESM Treaty had to be put on hold due to some politically difficult open issues regarding the lending capacity, the decision-making procedure, private sector involvement and the ratification threshold. At the Eurogroup of 29 November 2011, the leveraging options (for the EFSF) were discussed and agreed.38

---

36 Statement by the Heads of State and Government of the Euro Area and the EU Institutions, Brussels 21-7-2011: Stabilization tools. An option for collateral arrangement was included on the request of Finland.
37 Euro Summit Statement 26-10-2011: Stabilization Mechanisms 17-22 ‘Firewalls’ refer to money that is available in the short term to limit the pressure of financial markets on vulnerable member states.
38 Eurogroup press conference by President Juncker and EFSF President Regling 7-11-2011. Paper presented by Regling. The two leveraging options were developed based on discussions with the private sector, no real attempt was made to put these solutions into practice, for it was not really needed.
As part of a package that included the TSCG (Fiscal Compact), the HOSG of the Euro Area in December 2011 endorsed the leveraging of the EFSF and agreed to the ESM coming into force already in July 2012 (instead of July 2013). They promised to reassess the size of the fund and the acceleration of payments into the fund.\(^{39}\) With regard to the decision-making, an emergency procedure was created in which a qualified majority of 85% was sufficient for providing financial stability. The Eurogroup of January 2012 finalized the agreement on the ESM Treaty, on the basis of the aforementioned elements, which meant that the ratification process could be started up again.

The debate continued for a couple more months, focusing on enhancing the overall capacity of the ESM-EFSF and speeding up the build-up of the ESM. One of the options was to go for a transfer of the unused EFSF guarantees into the ESM, which was beneficial for the member states because ESM guarantees did not weigh on their balance sheets. Another option was to go for a coexistence of both mechanisms. The question here was whether to combine the full ESM capacity with the used EFSF capacity, or to combine the full capacities of both funds. Urged on by the Euro Summit of March, the Eurogroup meeting of 30 March 2012 provided the enhanced firewalls required. It agreed to increase the overall capacity (of EFSF and ESM combined) to 700 billion and to accelerate the transfer of paid-in capital.\(^{40}\) The March 2012 deal constituted the final major decision. In May and June 2012 the debate was about technical directives that would allow the ESM to become operational, after ratification. After the German Constitutional Court ruled that the ESM Treaty was not in conflict with the German constitution, Germany ratified the ESM. The threshold of 90 per cent (of paid-in capital) was thereby reached and the ESM came into force on 27 September 2012.

Finally, the negotiations about direct recapitalization of banks were part of a different process: the setting up of the banking union.\(^{41}\) Direct recapitalization would be part of the grand bargain to break the vicious circle between banks and sovereigns at the June 2012 Summit, where it was linked to a single resolution mechanism. It would remain a rather top-

\(^{39}\) Statement by the Euro Area Heads of State or Government, Brussels 9-12-2011: Strengthening the stabilization tools, 11-15.

\(^{40}\) Statement of the Eurogroup, 30-03-2012

\(^{41}\) In September 2011, this vicious circle started to feature in Commission papers, after which it was picked up by experts like Paul de Grauwe, but it would become part of the negotiations only in the Spring of 2012.
down intergovernmental process, which explains why there was never a buy-in from the German finance ministry. The machine room proceedings would take two years, with the institutions becoming less and less enthusiastic now that the instrument was linked to the bail-in discussions as part of the Bank Recovery and Resolution Directive (BRRD). An intermediate agreement on direct recapitalization was reached in June 2013 and a final agreement in July 2014.
## Appendix II: Overview of key moments in the ESM negotiations.

<table>
<thead>
<tr>
<th>Time frame</th>
<th>Level of the negotiations</th>
<th>Substance of the debate</th>
</tr>
</thead>
<tbody>
<tr>
<td>09-10 May 2010</td>
<td>Eurogroup/Ecofin</td>
<td>First reflections on the possibilities for ’establishing a permanent crisis resolution framework’</td>
</tr>
<tr>
<td>12 May 2010</td>
<td>European Commission</td>
<td>Announces the intention ‘in the medium-to-long term to make a proposal for a permanent crisis resolution mechanism.’</td>
</tr>
<tr>
<td>21 May 2010</td>
<td>Task Force on economic governance</td>
<td>The development of an effective crisis mechanism is mentioned as one of the four objectives, but the matter was not discussed in the Task Force.</td>
</tr>
<tr>
<td>21 October 2010</td>
<td>Task Force on economic governance</td>
<td>Final report notes that: ‘The setting-up of a crisis resolution framework requires further work. As it may imply a need for Treaty changes, it is an issue for the European Council’.</td>
</tr>
<tr>
<td>28-29 October 2010</td>
<td>European Council</td>
<td>Endorses the possibility of limited Treaty change to allow the establishment of the ESM.</td>
</tr>
<tr>
<td>28 November 2010</td>
<td>Eurogroup</td>
<td>Discusses modalities of the ESM, on basis of Commission proposals in cooperation with European Council President. Agrees to a full programme for Ireland, after having acknowledged the option of a precautionary programme.</td>
</tr>
<tr>
<td>16-17 December 2010</td>
<td>European Council</td>
<td>Endorses the modalities and agrees to the minor Treaty change, to highlight the compatibility of an intergovernmental ESM with the EU Treaty. Calls upon the Eurogroup to finalise work on this mechanism by March 2011.</td>
</tr>
<tr>
<td>10 January 2011</td>
<td>European Commission</td>
<td>Presents first (of many) option paper, entitled ’Reflections on a possible European Stability Mechanism’ which introduces the basic features of possible instruments, along with their advantages and disadvantages.</td>
</tr>
<tr>
<td>January to March 2011</td>
<td>TFCA and EWG</td>
<td>In a series of meetings, discuss current limitations and complications w.r.t. the fund: limited lending capacity, statistical treatment by Eurostat and the high interest rate. Develop and discuss a range of new instruments: a.o (primary and secondary) market operations, precautionary facility, (direct and indirect) recapitalization of financial institutions.</td>
</tr>
<tr>
<td>11 March 2011</td>
<td>Euro Summit</td>
<td>Agrees to (loans and) primary markets operations. Vows to make the 440 billion of the EFSF fully effective. Calls upon the</td>
</tr>
<tr>
<td>Date</td>
<td>Institution</td>
<td>Description</td>
</tr>
<tr>
<td>--------------</td>
<td>-----------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>24-25 March 2011</td>
<td>European Council</td>
<td>Endorses (without discussion) a term sheet on the ESM, that set out the contours of an agreement on the size, the terms and conditions, and the decision-making procedures.</td>
</tr>
<tr>
<td>16 May 2011</td>
<td>Eurogroup</td>
<td>When agreeing to the programme for Portugal, agrees to raise the EFSF guarantees to 720 billion euro, thereby restoring the effective lending capacity of 440 billion.</td>
</tr>
<tr>
<td>20 June 2011</td>
<td>Eurogroup+</td>
<td>Formally agrees on the ESM Treaty, which was subsequently endorsed by the European Council in June 2011 and then signed by the finance ministers at their meeting in July.</td>
</tr>
<tr>
<td>21 July 2011</td>
<td>Euro Summit</td>
<td>Agrees ‘to improve the effectiveness of the EFSF and of the ESM...to increase their flexibility linked to appropriate conditionality’. Endorses new instruments: precautionary programmes, indirect recapitalization and secondary market operations. Also agrees to use the interest rates for Greece (3.5%, equivalent to the Balance of Payment facility) also for Portugal and Ireland.</td>
</tr>
<tr>
<td>16 September 2011</td>
<td>Eurogroup</td>
<td>Further discussions on adjustments to the framework and on lowering the interest rate. First brief discussion on the idea of leveraging.</td>
</tr>
<tr>
<td>September to November 2011</td>
<td>TFCA and EWG (and Eurogroup)</td>
<td>Explore options to increase the capacity of the funds, initially focusing on leveraging (and a single discussion on banking license).</td>
</tr>
<tr>
<td>26 October 2011</td>
<td>Euro Summit</td>
<td>Discusses ways to enhance the size of the EFSF and ESM (‘firewalls’), mainly through leveraging. Endorses two leveraging options.</td>
</tr>
<tr>
<td>7 November 2011</td>
<td>Eurogroup</td>
<td>The process of signing the ESM Treaty is put on hold, due to some politically difficult open issues, regarding the lending capacity, the decision-making procedure, private sector involvement and the ratification threshold.</td>
</tr>
<tr>
<td>29 November 2011</td>
<td>Eurogroup</td>
<td>Discusses and agrees to the two leveraging options (for the EFSF). Explores other ways to enhance the capacity.</td>
</tr>
<tr>
<td>9 December 2011</td>
<td>Euro Summit</td>
<td>As part of a package that included the TSCG (Fiscal Compact), agrees to the ESM coming into force already in July 2012 (instead of July 2013). Promises to reassess the size of the</td>
</tr>
<tr>
<td>Date</td>
<td>Group/Event</td>
<td>Action</td>
</tr>
<tr>
<td>--------------</td>
<td>------------------------------</td>
<td>------------------------------------------------------------------------</td>
</tr>
<tr>
<td>23 January 2012</td>
<td>Eurogroup</td>
<td>Finalizes agreement on the ESM Treaty, which meant that the ratification process can be started up again.</td>
</tr>
<tr>
<td>February and March 2012</td>
<td>TFCA and EWG</td>
<td>Develop and discuss options for enhancing the capacity of the funds, by merging EFSF and ESM or allowing them to coexist.</td>
</tr>
<tr>
<td>1-2 March 2012</td>
<td>European Council</td>
<td>Signs the TSCG (Fiscal Compact) in the margins of the meeting. Reminds the Eurogroup that a deal on the EFSF/ESM capacity needs to be reached by the end of the month.</td>
</tr>
<tr>
<td>12 March 2012</td>
<td>Eurogroup</td>
<td>Discusses but fails to reach an agreement on the overall capacity and passes the matter back to the EWG.</td>
</tr>
<tr>
<td>30 March 2012</td>
<td>Eurogroup</td>
<td>Agrees to increase the overall capacity (of EFSF and ESM combined) to 700 billion and to paying in two tranches both in 2012 and 2013.</td>
</tr>
<tr>
<td>29 June 2012</td>
<td>Euro Summit</td>
<td>Agrees to create a direct recapitalization facility, linked to the establishment of a single supervisory mechanism (SSM) as part of a banking union.</td>
</tr>
<tr>
<td>27 September 2012</td>
<td>Germany</td>
<td>Ratifies the ESM, whereby the threshold of 90% of paid-capital is reached and the ESM enters into force.</td>
</tr>
</tbody>
</table>
Appendix III: Overview of the decision-making and the role of the institutions.

This table below provides a comprehensive overview of the role of the institutions in the ESM (and related EFSF) process. It addresses four questions:

1. What were the main decisions on the structural features of the ESM?\textsuperscript{42}
2. When was the issue debated and when were the decisions made?
3. At what level was an agreement reached on the matter?
4. What was the role of the institutions in the process?

\textsuperscript{42} We include decisions on the key features of the ESM that came about indirectly, that is through decisions on the features of the EFSF which were subsequently taken over into the ESM.
<table>
<thead>
<tr>
<th>Issue for debate</th>
<th>1. decision</th>
<th>2. time frame</th>
<th>3. level of decision</th>
<th>4. role of institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Size</td>
<td>Size or capacity of the ESM</td>
<td>Debate: January 2011 – March 2011 and December 2011 – March 2012</td>
<td>Both instances: prepared at the technical level by the TFCA, then agreed by the EWG and by Eurogroup, endorsed by the Euro Summit.</td>
<td>Significant institutional involvement. The amount (at least as much as EFSF and EFSM together, i.e. € 500 billion) was included in the first working paper drafted by the Commission in cooperation with the TFCA Chair, presented to the TFCA in January 2011. The idea to combine the funds as a means to raise the joint capacity to 700 billion was developed by Commission and EFSF.</td>
</tr>
<tr>
<td>Form of MS contributions (and accelerated payments)</td>
<td></td>
<td>Both instances: prepared at the technical level by the TFCA, then agreed by the EWG and by Eurogroup, endorsed by the Euro Summit.</td>
<td>Significant institutional involvement. Initial proposals for capital structure were included in the first working paper presented to the TFCA in January 2011, drafted by the Commission, in cooperation with the TFCA Chair. Further developed by the TFCA, with input from the EFSF regarding the necessary capital structure to obtain AAA rating, and from Eurostat on the likelihood of ESM being considered an independent institution so that its operations would not increase the public debt of the euro area member states. The option to accelerate payments was already included in the term sheet.</td>
<td></td>
</tr>
<tr>
<td>Topic</td>
<td>Debate:</td>
<td>Decision:</td>
<td>Description</td>
<td></td>
</tr>
<tr>
<td>------------------------------</td>
<td>-----------------------------</td>
<td>-----------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td></td>
</tr>
<tr>
<td><strong>Leveraging</strong></td>
<td>September- November 2011</td>
<td>October 2011</td>
<td>Principle agreed by Euro Summit. Modalities discussed by TFCA and EWG. Agreed at Eurogroup November 2011. Significant institutional involvement. The EFSF itself drafted solution, two leverage options and conditions. EFSF and Commission were prominently involved in the debate at TFCA and EWG level.</td>
<td></td>
</tr>
<tr>
<td><strong>Banking license</strong></td>
<td>September - December 2011</td>
<td>no decision</td>
<td>Briefly mentioned at EWG level, but issue never agreed on, and it never made it onto the negotiation table. Resurfaced as part of Van Rompuy's contribution to European Council debate in December 2011. Limited institutional involvement. The instrument was pushed for by one member state in particular, but steadily opposed by some others and by the ECB.</td>
<td></td>
</tr>
</tbody>
</table>

**2. Scope**

<table>
<thead>
<tr>
<th>Topic</th>
<th>Debate:</th>
<th>Decision:</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary market interventions</td>
<td>January - March 2011</td>
<td>March 2011</td>
<td>Prepared at the technical level by the TFCA, then agreed by the EWG and by Eurogroup, endorsed by the Euro Summit. Significant institutional involvement. Instrument was included in the first working paper presented to the TFCA in January 2011. It was drafted by the Commission, in cooperation with the TFCA Chair.</td>
</tr>
<tr>
<td>Secondary market interventions</td>
<td>January - July 2011</td>
<td>July 2011</td>
<td>Prepared at the technical level by the TFCA, then agreed by the EWG and by Eurogroup, endorsed by the Euro Summit. Significant institutional involvement. It was first mentioned by the ECB in its contribution to the Task Force on Economic Governance, then included in the first working paper presented to the TFCA in January 2011. It was drafted by the Commission, in</td>
</tr>
</tbody>
</table>
Precautionary programmes (precautionary credit lines) | Debate: November 2010 - July 2011 Decision: July 2011 | Idea was first raised at the EWG level in November 2010 i.r.t. EFSF/EFSM programme for Ireland. Subsequently prepared at the technical level by the TFCA, then agreed by the EWG and by Eurogroup, endorsed by the Euro Summit | Significant institutional involvement. The idea came from the IMF toolkit, but it was pushed for by the Commission. It was included after increasing market pressures obliged the Euro Summit to agree on additional instruments.

Indirect recapitalization (of banks) | Debate: July 2011 Decision: July 2011 | Principle agreed by Euro Summit. Developed and debated at EWG and joint EWG/Sherpa meetings in preparation of Euro Summit of 21 July 2011. | Significant institutional involvement. The idea had its origin in concerns regarding the impact that the PSI exercise (bond exchange), that was planned for Greece in the context of the 2nd programme would have on banks in non-programme countries. The idea came from and was pushed for by Commission.

3. Terms and conditions | Interest rates and maturity | Debate: March – July 2011 Decision: March 2011, | General agreement to level the ESM interest rates to the GLF and IMF loans by Euro Summit | Significant institutional involvement. Technical details on the structure worked out by TFCA with input from the Commission and
<table>
<thead>
<tr>
<th>Category</th>
<th>Date Range</th>
<th>Description</th>
<th>Institutional Involvement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Macro-economic adjustment programme</td>
<td>July 2011</td>
<td>Final preparations by several EWG meetings and a joint EWG / Sherpa meeting in July 2011, based on a paper on EFSF flexibility drafted by the Commission.</td>
<td>No institutional involvement required. None of the parties questioned the principle to avoid moral hazard – and that strong conditionality was a way to ensure that.</td>
</tr>
<tr>
<td>IMF involvement</td>
<td>Debate: n.a.</td>
<td>Modalities taken over from EFSF.</td>
<td>No institutional involvement required. None of the parties questioned the principle, ever since Greek Loan Facility (GLF) and EFSF.</td>
</tr>
<tr>
<td>Private sector involvement</td>
<td>Debate: October 2010 – October 2011</td>
<td>Intergovernmental deal. Franco-German Deauville declaration, endorsed by the Eurogroup in November 2010 and the European Council in December 2010.</td>
<td>Limited institutional involvement. Technical details on Collective Action Clauses were worked out by the TFCA, drawing on input from the Commission and the EFC Sub-Committee on EU Sovereign Debt Markets (ESDM), approved by the EWG and Eurogroup.</td>
</tr>
</tbody>
</table>
| 4. Decision-making procedures | Link to TSCG (Fiscal Compact) | Debate: December 2011  
Decision: December 2011 | Intergovernmental deal.  
Discussed and agreed by European Council. | Limited institutional involvement.  
Included upon insistence of one member state |
|-------------------------------|-------------------------------|-----------------------------|------------------------------------------|--------------------------------------------------|
| Involvement of member states and institutions, direct/indirect. | Debate: n.a.  
Decision: n.a. | Modalities taken over from EFSF. | Limited institutional involvement.  
Commission in liaison with the ECB to negotiate the conditionality, sign the MoU and are in charge of implementation of programme. |  |
| Process of decision-making | Debate: January – March 2011  
Decision: March 2011 | Modalities largely taken over from EFSF. New element prepared at the technical level by the TFCA, then agreed by the EWG and by Eurogroup, endorsed by the Euro Summit. | Some institutional involvement.  
New element is majority voting/decision by managing director enhanced on certain issues (e.g. calling in capital in individual cases), in order to ensure treatment of the ESM as an independent institution by the Eurostat. |  |
| Emergency procedure | Debate: October 2011 - December 2011  
Decision: December 2011 | First discussed at the TFCA in October 2011, but only agreed on by the Euro Summit on 9 December 2011. (Relevant member state could not endorse it.) Further details were worked out at the Eurogroup of January 2012. | Significant institutional involvement.  
Idea, which was politically very contentious for one of member states at least, came out of discussions at TFCA level and was intended to reassure markets on the ability of the ESM to take the necessary decisions even in emergency situations. It was part of a report by the Chair of the TFCA to the EWG. |  |